

Internal Revenue Service  
**memorandum**

CC:TL-N-7964-87  
Br2:JMorenstein

date: JUL 8 1987

to: District Counsel, San Francisco  
Attn: Debra K. Estrem

CC:SF

from: Director, Tax Litigation Division

CC:TL

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subject: Settlement of Request for Costs  
[REDACTED]

This is in response to your memorandum of May 26, 1987, by which you requested our views as to whether the Government should pay the sum of \$100.00 in settlement of the petitioner's request for litigation costs.

Suit on the substantive matter in this case was filed by the petitioner on [REDACTED] and it is our understanding that a stipulated decision, showing no deficiency, has been prepared and will be submitted to the Tax Court subsequent to the petitioner signing it. It is our further understanding that the petitioner currently refuses to sign until the litigation costs issue is settled.

ISSUE

Whether the Government should pay petitioner the sum of \$100.00 in full settlement of petitioner's claim for litigation costs. 7430.00-00.

CONCLUSION

As the Service has prepared a stipulated decision showing no deficiency and as the facts leading up to the filing of the petition are so egregious, the offer proposed by the petitioner should be accepted.

DISCUSSION

Facts:

Petitioner, [REDACTED], is a duly ordained minister who elected to be exempt from self-employment tax pursuant to I.R.C. § 1402(e). As a result, along with his [REDACTED] tax return, petitioner filed a Form 4361 Application for Exemption From Self-Employment Tax for Use by Ministers, Members of Religious Orders and Christian Science Practitioners. These documents were filed on or about

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██████████. Petitioner had filed for an automatic extension to file his return which automatically extended the time for filing Form 4361.

Upon receipt of the tax return, the Service Center inadvertently failed to remove the timely filed Form 4361 from the back of petitioner's ██████████ tax return for separate processing. When petitioner did not receive notice of his application's approval, he contacted the Service to inquire as to the status of his application. Petitioner was told that no Form 4361 had ever been received and that he should submit another so that the form would be in the Service's files. Upon receipt of the second Form 4361 the Service Center refused approval on the grounds that the application was not timely filed. By letter dated ██████████, the petitioner was so informed.

Subsequently, the Service Center discovered its processing error and on ██████████, the original Form 4361 was approved. On ██████████, petitioner received a letter to this effect. Nonetheless, on ██████████, the Service Center issued a statutory notice of deficiency for ██████████ in the amount of \$██████████. The only adjustment accounting for the deficiency was the addition of self-employment tax. Additionally, no 30-day letter was ever issued to the petitioner.

On ██████████, petitioner filed a petition with the Tax Court. The District Counsel attorney was unable to obtain the administrative file within the time the answer was due to be filed with the Tax Court and as a result, all material allegations in the petition were denied.

Petitioner now seeks the sum of \$██████████ in full settlement of his claim for litigation costs.

#### Legal Analysis:

I.R.C. § 7430 provides generally that in civil tax proceedings brought by or against the United States, "the prevailing party may be awarded a judgment...for reasonable litigation costs incurred in such proceeding." In order to recover costs under this section the petitioner must first show that all administrative remedies have been exhausted. In the present case, a notice of deficiency was sent to the petitioner without any 30-day letter having previously been issued. In such a case, Treas. Reg. § 301.7430-1(f)(2) states that an exception to the requirement that the petitioner pursue his

administrative remedies will be recognized in the case of a petition to the Tax Court where:

(i) The party did not receive a preliminary notice of proposed deficiency (30-day letter) prior to the issuance of the statutory notice of deficiency and the failure to receive such notice was not due to actions of the party...; and

(ii) The party does not refuse to participate in an Appeals office conference while the case is in docketed status.

Thus, the requirement of exhausting administrative remedies is not an obstacle to petitioner's recovery.

To recover litigation costs, it is also incumbent upon the petitioner to show that he was a prevailing party. The term "prevailing party" is defined in section 7430(c)(2). This definition sets out two basic requirements. First, the petitioner must show that he has substantially prevailed with respect to the substantive issue involved in the case. As the respondent has proposed a total concession it is clear that the petitioner has met this requirement.

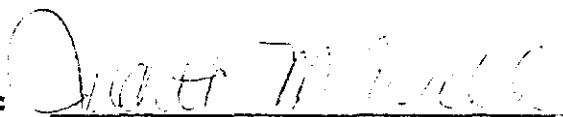
The second, and often more troublesome, requirement is that the petitioner must establish that the position of the United States was not substantially justified. The phrase "position of the United States" is defined in section 7430(c)(4). Section 7430(c)(4) was added to the statute by section 1551(e) of the Tax Reform Act of 1986, Pub. L. No. 99-514 (1986), and applies generally for amounts paid after September 30, 1986, in civil actions commenced after December 31, 1985. The statute defines "position of the United States" as including "any administrative action or inaction by the District Counsel of the Internal Revenue Service (and all subsequent administrative action or inaction) upon which such proceeding is based." Therefore, in cases subsequent to December 31, 1985, the courts will look beyond the Government's litigating position and will examine the events leading up to the litigation.

While the court may consider the administrative posture of the case, the Service did not technically run afoul of the statute's requirement that the administrative action taken by the District Counsel be substantially justified. The only action that the District Counsel undertook was to answer the taxpayer's petition. That, in and of itself, is not sufficient to hold that the Service's position was not substantially justified. See, Spirtis v. Commissioner, T.C. Memo. 1985-44.

While the Service's actions in this case were, technically, substantially justified, as defined by the statute, the facts of this case are so egregious that the Service would encounter severe litigation hazards if it pursued this case. Inasmuch as the Government's case was wholly without merit, the offer to settle this case for \$[REDACTED] is very reasonable. This amount is especially reasonable in light of the fact that the taxpayer incurred costs of \$60.00 merely by filing the tax court petition. There are substantial hazards involved in litigating this case and the small amount of money involved is not worth taking the risk of losing in litigation and establishing adverse precedent. As a result, we concur in your recommendation that the petitioner's offer be accepted.

ROBERT P. RUWE

By:

  
JUDITH M. WALL  
Senior Technician Reviewer  
Branch No. 2  
Tax Litigation Division

cc: Jerry Horan, CC:TL:Br1